

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05
CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04
SIL-01 DODE-00 PA-01 PRS-01 IGA-02 /082 W
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FM AMEMBASSY SANTIAGO

TO SECSTATE WASHDC 2831

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E. O. 11652: N/A

TAGS: EFIN, CI

SUBJECT: TROUBLES IN CHILE'S FINANCE COMPANIES SPREAD

REF: SANTIAGO 12082

1. SUMMARY: ON DECEMBER 28 THE GOC INTERVENED ANOTHER SMALL SANTIAGO FINANCE COMPANY AMIDST RUMORS THAT STILL OTHERS AND SOME SEVEN COMMERCIAL BANKS FACE LIQUIDITY PROBLEMS AS A CONSEQUENCE OF DEFAULTED LOANS AND LAX MANAGEMENT. INVESTOR NERVOUSNESS HAS LED TO LARGE DEPOSIT WITHDRAWALS WORSENING THE CASH FLOW PROBLEMS OF SOUND AND UNSOUND FINANCIAL INSTITUTIONS ALIKE. MEANWHILE, PRESIDENT PINOCHET, IN A HIGH-LEVEL MOVE TO STILL INVESTOR FEARS, HAS PROMISED DRASTIC MEASURES TO PUT A HALT TO CERTAIN IRREGULAR PRACTICES IN SOME FINANCE COMPANIES (FINANCIERAS). AS YET, IT REMAINS UNCERTAIN WHETHER THE GOC WOULD INTERVENE WITH FINANCIAL SUPPORT SHOULD THIS FINANCIAL CRISIS SPREAD. END SUMMARY.

2. ON DECEMBER 28 THE GOC INTERVENED A THIRD FINANCE COMPANY WITHIN A WEEK AND THERE IS STILL NO INDICATION THAT THE TIDE OF FAILURES IS ABOUT TO RECEDE. MOST OF CHILE'S OTHER FINANCE COMPANIES AND SEVEN OF SANTIAGO'S 14 COMMERCIAL BANKS ARE REPUTEDLY FACING LIQUIDITY PROBLEMS AND/OR PROBLEMS WITH MEETING RESERVE
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REQUIREMENTS.

3. THE LATEST CASUALTY WAS THE SMALL SANTIAGO SAVINGS AND LOAN COOPERATIVE "LA FAMILIA", AN INSTITUTION LINKED WITH CATHOLIC UNIVERSITY FACULTY MEMBERS, AND HAVING AMONG ITS DIRECTORS TWO LEADERS OF THE GOC-BACKED NATIONAL YOUTH ORGANIZATION, A MINISTRY OF LABOR OFFICIAL, AND TWO OF (NOW FINANCE MINISTER)

SERGIO DE CASTRO'S "WHIZ KIDS" FROM THE MINISTRY OF ECONOMY.

4. THE IMMEDIATE CAUSE OF LA FAMILIA'S COLLAPSE WAS THE FAILURE OF ONE OF ITS DEBTORS, A LOCAL CONSTRUCTION COMPANY. MORE THAN HALF OF LA FAMILIA'S ASSETS HAD BEEN PLACED IN A CONSORTIUM OF WHICH THE FAILED FIRM WAS A PRINCIPAL ELEMENT. NOT ONLY IS THERE EVIDENCE OF INCOMPETENCE BUT ALSO A WHIFF OF IMPROPRIETY IN LA FAMILIA'S AFFAIRS. ACCORDING TO RUMOR, THE HEAD OF CATHOLIC UNIVERSITY RECENTLY HAD SCHOOL FUNDS UNDER HIS SUPERVISION WITHDRAWN FROM LA FAMILIA. THE HEAVY INVOLVEMENT OF CATHOLIC UNIVERSITY FACULTY MEMBERS IN LA FAMILIA SUGGESTS AT LEAST THE POSSIBILITY OF INSIDE INFORMATION.

5. AMONG THE MORE EMBARRASSING DETAILS TO SURFACE FROM THE SCANDAL HAS BEEN THE DECIMATION OF THE REGULATORY BODY (SUPERINTENDENCY OF BANKING AND FINANCIAL INSTITUTIONS) CHARGED WITH ENFORCING LEGAL REQUIREMENTS ON FINANCIAL INSTITUTIONS. ACCORDING TO NEWSPAPER REPORTS, THE SUPERINTENDENCY'S INVESTIGATORY STAFF HAD FALLEN TO LESS THAN HALF ITS AUTHORIZED SIZE AS THE RESULT OF RESIGNATIONS INDUCED BY AN ENEMY PAY SCALE. AS A CONSEQUENCE, IRREGULARITIES WITH RESPECT TO RESERVE REQUIREMENTS AND FINANCIAL REPORTING HAVE APPARENTLY BECOME ENDEMIC. ALTHOUGH PRESIDENT PINOCHET HAS PROMISED DRASTIC MEASURES TO CORRECT IRREGULARITIES, SAVERS MAY NOT BE VERY MUCH SOOTHED BY THESE ASSURANCES.

6. THERE ARE NO INDICATIONS OF WHAT STEPS THE GOC CONTEMPLATES TO BOLSTER A FALTERING FINANCIAL SYSTEM SHOULD A RUN DEVELOP ON OTHER FINANCIERAS AND FINANCIAL INSTITUTIONS REPUTEDLY LESS THAN SOUND. GOC INTERVENTION TO SAVE THE SAVINGS AND LOAN LIMITED OFFICIAL USE

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SYSTEM EXACTLY TWO YEARS AGO PROVED VERY EXPENSIVE AND TROUBLE-PLAGUED. ON THE OTHER HAND, FAILURE TO ACT COULD HAVE FAR-REACHING CONSEQUENCES FOR ECONOMIC RECOVERY AND BRING LARGE FINANCIAL LOSSES TO MIDDLE CLASS GOC SUPPORTERS.

7. WHETHER THE GOC IS ABLE TO HEAD OFF A SERIOUS FINANCIAL CRISIS OR NOT, OPPONENTS OF THE ECONOMIC TEAM HAVE BEEN HANDED SOME POWERFUL AMMUNITION WITH WHICH TO ATTACK FREE MARKET POLICIES IN THE MONTHS AHEAD. EASING CONTROLS ON FINANCIAL MARKETS APPARENTLY HAS NOT IMPROVED RESOURCE ALLOCATION AS PROPONENTS ARGUED, AND THE SYSTEM IN THE PRESENT LAISSEZ FAIRE ATMOSPHERE IS DEMONSTRABLY UNSTABLE.

8. FINALLY, CHARGES THAT THE ECONOMIC TEAM OPERATES IN A TEXTBOOK WORLD HAVE BEEN GIVEN MORE SUBSTANCE. CENTRAL BANK PRESIDENT (NOW MINISTER OF ECONOMY) PABLO BARAONA, EXERCISING AN UNHAPPY PENCHANT FOR INEPT OBSERVATIONS, COMMENTED A FEW DAYS AGO THAT INVESTORS WOULD HAVE TO LEARN TO EVALUATE THE LIQUIDITY SITUATIONS OF SAVINGS INSTITUTIONS. IN THE CLUBBLY ATMOSPHERE

OF SANTIAGO'S FINANCIAL POLITICS, SUCH INFORMATION IS LIKELY
TO BE AVAILABLE ONLY TO INSIDERS AND THEIR FRIENDS.
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